

variances may be combined into one material-cost variance account.

(c) Labor-cost variances shall be recognized at the time labor cost is introduced into production units. Labor-rate variances and labor-time variances may be combined into one labor-cost variance account. A separate labor-cost variance shall be accumulated for each production unit.

(d) A contractor's established practice with respect to the disposition of variances accumulated by production unit shall be in accordance with one of the following subparagraphs:

(1) Variances are allocated to cost objectives (including ending in-process inventory) at least annually. Where a variance related to material is allocated, the allocation shall be on the basis of the material cost at standard, or, where outputs are homogeneous, on the basis of units of output. Similarly, where a variance related to labor is allocated, the allocation shall be on the basis of the labor cost at standard or labor hours at standard or, where outputs are homogeneous, on the basis of units of output; or

(2) Variances which are immaterial may be included in appropriate indirect cost pools for allocation to applicable cost objectives.

(e) Where variances applicable to covered contracts are allocated by memorandum worksheet adjustments rather than in the books of account, the bases used for adjustment shall be in accordance with those stated in paragraph (b)(3) and paragraph (d) of this subsection.

#### 9904.407-60 Illustrations.

(a) Contractor A's written practice is to set his material-price standard for an item on the basis of average purchase prices expected to prevail during the calendar year. For that item whose usage from month to month is stable, a purchase contract is generally signed on May 1 of each year for a 1-year commitment. The current purchase contract calls for a purchase price of \$3 per pound; an increase of 5 percent, or 15¢ per pound, has been announced by the vendor when the new purchase contract comes into effect next May. Contractor A sets his material-price standard for this item at \$3.10 per pound for the

year ( $[\$3.00 \times 4 + \$3.15 \times 8] \div 12$ ). Since Contractor A sets his material-price standard in accordance with his written practice, he complies with provisions of 9904.407-40(c) of this Cost Accounting Standard.

(b) Contractor B accumulates, in one account, labor cost at standard for a department in which several categories of direct labor of disparate functions, in different combinations, are used in the manufacture of various dissimilar outputs of the department. Contractor B's department is not a production unit as defined in 9904.407-30(a)(7) of this Cost Accounting Standard. Modifying his practice so as to comply with the definition of production unit in 9904.407-30(a)(7), he could accumulate the standard costs and variances separately,

(1) For each of the several categories of direct labor, or

(2) For each of several subdepartments, with homogeneous output for each of the subdepartments.

(c) Contractor C allocates variances at the end of each month. During the month of March, a production unit has accumulated the following data with respect to labor:

	Labor hours at standard	Labor dollars at standard	Labor cost variance
Balance, March 1 .....	5,000	\$25,000	\$2,000
Additions in March .....	15,000	75,000	5,000
Total .....	20,000	100,000	7,000
Transfers-out in March ..	8,000	40,000	
Balance, March 31 .....	12,000	60,000	

Using labor hours at standard as the base, Contractor C establishes a labor-cost variance rate of \$.35 per standard labor hour ( $\$7,000 \div 20,000$ ), and deducts \$2,800 ( $\$.35 \times 8,000$ ) from the labor-cost variance account, leaving a balance of \$4,200 ( $\$7,000 - \$2,800$ ). Contractor C's practice complies with provisions of 9904.407-50(d)(1) of this Cost Accounting Standard.

(d) Contractor D, who uses materials the prices of which are expected to fluctuate at different rates, recognizes material-price variances at the time purchases of material are entered into the books of account. He maintains one purchase-price variance account for the whole plant. Purchased items are

requisitioned by various production units in the plant. Since prices of material are expected to fluctuate at different rates, this plant-wide grouping does not constitute a homogeneous grouping of material. Contractor D's practice does not comply with provisions of 9904.407-50(b)(2) of this Cost Accounting Standard. However, if he would maintain several purchased-items inventory accounts, each representing a homogeneous grouping of material, and maintain a material-price variance account for each of these homogeneous groupings of material, Contractor D's practice would comply with 9904.407-50(b)(2) of this Cost Accounting Standard.

(e)(1) Contractor E recognizes material-price variances at the time purchases of material are entered into the books of account and allocates variances at the end of each month. During the month of May, a homogeneous grouping of material has accumulated the following data:

	Material cost at standard	Material price variance
Inventory, May 1 .....	\$150,000	\$20,000
Additions in May .....	1,850,000	120,000
Total .....	2,000,000	140,000
Requisitions:		
Production Unit 1 .....	900,000	.....
Production Unit 2 .....	450,000	.....
Production Unit 3 .....	300,000	.....
Production Unit 4 .....	150,000	.....
Inventory, May 31 .....	200,000	.....

(2) Contractor E establishes a material-price variance rate of 7% (\$140,000 ÷ \$2,000,000) and allocates as follows:

	Material cost at standard	Material price variance rate (%)	Material price variance allocation
Production Unit 1 .....	\$900,000	7	\$63,000
Production Unit 2 .....	450,000	7	31,500
Production Unit 3 .....	300,000	7	21,000
Production Unit 4 .....	150,000	7	10,500
Ending inventory of homogeneous grouping of material	200,000	7	14,000
Total .....	2,000,000	.....	140,000

Contractor E's practice complies with provisions of 9904.407-50(b)(3)(ii) of this Cost Accounting Standard.

(f)(1) Contractor F makes year-end adjustments for variances attributable

to covered contracts. During the year just ended, a covered contract was processed in four production units, each with homogeneous outputs. Data with respect to output and to labor of each of the four production units are as follows:

Production unit	Total units of output	Total units used by the covered contract	Total labor costs at standard	Total labor-cost variance
1 .....	100,000	10,000	\$400,000	\$20,000
2 .....	30,000	6,000	900,000	30,000
3 .....	20,000	5,000	600,000	10,000
4 .....	10,000	4,000	500,000	20,000

(2) Since the outputs of each production unit are homogeneous, Contractor F uses the units of output as the basis of making memorandum worksheet adjustments concerning applicable variances, and establishes the following figures:

	Labor-cost variance per unit of unit	Units used by the covered contract	Labor-cost variance attributable to the covered contract
Production Unit 1 .....	\$0.20	10,000	\$2,000
Production Unit 2 .....	1.00	6,000	6,000
Production Unit 3 .....	.50	5,000	2,500
Production Unit 4 .....	2.00	4,000	8,000
Total labor-cost variance attributable to the covered contract	.....	.....	18,500

(3) Contractor F makes a year-end adjustment of \$18,500 as the labor-cost variances attributable to the covered contract. Contractor F's practice complies with provisions of 9904.407-50(e) of this Cost Accounting Standard.

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#### 9904.407-61 Interpretation. [Reserved]

#### 9904.407-62 Exemption.

None for this Standard.

#### 9904.407-63 Effective date.

This Standard is effective as of April 17, 1992. Contractors with prior CAS-covered contracts with full coverage shall continue this Standard's applicability upon receipt of a contract to